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National Dairy Policy

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PROFILE OF THE DAIRY INDUSTRY IN CANADA

The agriculture and food sector accounts for 5% of Canada's Gross Domestic Product. Within agriculture, dairying is the second largest contributing sector, cereals being the largest.

In 1985, 44,000 farms (or producers) were reported as having shipments of milk or cream. Directly and indirectly, an estimated 80,000 people are employed at the dairy farm level while 25,000 workers are employed in the dairy processing sector. With sales of over \$6 billion, the dairy industry accounts for 17% of the gross output of the food and beverage industry and thus makes a significant contribution to the national economy.

- ° Number of milk cows and dairy heifers: 2,389,300 head in 1985.
- ° Total farm sales of milk and cream: 73.461 million hectolitres in 1984-85.
- ° Farm cash receipts from dairying: \$3.2 billion in 1985.

LIST OF ABBREVIATIONS

CDC: Canadian Dairy Commission

CMSMC: Canadian Milk Supply Management Committee

DFC: Dairy Farmers of Canada

DBC: Dairy Bureau of Canada

NDC: National Dairy Council of Canada

MCP: Multiple Component Pricing

MSQ: Market Sharing Quota

SNF: Solids non-fat

SMP: Skim Milk Powder



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NATIONAL DAIRY POLICY

INTRODUCTION

There has been considerable federal government intervention in the dairy industry since the end of the First World War. Whether or not the decisions taken on dairying (in Canada) up to the mid 1960s could be called policy in the true sense of the word is open to question. They were made largely on an ad hoc basis to achieve three aims: to establish reasonable prices for consumers, to fulfill export commitments to Great Britain during and immediately after World War II, and to provide reasonable returns for producers. Producer and consumer subsidies and incentives on butter and cheese production were used to steer production and consumption patterns and their implementation was often carried out with little regard for the changing structure of the industry or its long-term viability. Also, federal dairy policy often found itself, if not at odds, then out of step with provincial policies. A brief history of the major decisions taken up to 1963 is given below.

THE EVOLUTION OF DAIRY POLICY IN CANADA

A. Dairy Production and Subsidies from the Depression to the Creation of the Canadian Dairy Commission(1)

The Depression of the 1930s had a major effect on agriculture in Canada, the dairy industry included. In 1931 and 1932, prices for manufacturing milk dropped to levels close to those at the turn of the century. As a result, some farmers who normally sold milk for manufacturing purposes began to sell on the fluid market, either directly to consumers or to fluid milk distributors. This disrupted the fluid milk market and destroyed what price stability there had been. To help remedy this situation, during the 1930s the provinces individually introduced and passed legislation to stabilize prices to the consumer and the producer. The legislation created boards which had the authority to make orders and regulations pertaining to the control of fluid milk and had broad responsibilities in the fields of milk pricing, licensing and bonding of distributors and allocation of producer quotas.

The legislation passed in each province had one of two purposes: to provide a sufficient quantity of milk for the consumer (as in the Prairie Provinces) or to provide a reasonable price to the producer (as in Ontario and Quebec). Manitoba and Alberta instituted fluid milk control by amending their Public Utilities Acts in 1932 and 1933 respectively. Saskatchewan empowered local Government Boards as milk control authorities. Ontario passed the first actual Milk Control Act in 1934, while Quebec had passed similar legislation in 1933.

World War II provided the Canadian dairy industry with considerably enhanced export markets but government controls prevented prices from reaching the level they could have enjoyed in a free market. For the first time, subsidy payments were made to dairy farmers in lieu of allowing them direct price increases for their products. This was done by the Dominion Marketing Board under the authority of the Natural Products Marketing Act of 1934. Manufacturers or dealers were also granted subsidies to help control farm input costs. In addition to being granted

(1) V. McCormick, A Hundred Years in the Dairy Industry in Canada, Dairy Farmers of Canada, Ottawa, 1968, p. 21.

subsidies on cheese, dairy farmers were encouraged by bonuses to produce milk for the manufacture of cheese for export to Britain. The subsidies and bonuses were successful for a while but input costs eroded their value and in the end, they did not have a great effect on cheese production. The subsidies did, however, divert total milk supply away from the manufacture of butter, the production of which actually fell to the point where imports were required from the United Kingdom, Australia and New Zealand. The Wartime Prices and Trade Board then saw fit to introduce further subsidies to encourage adequate butter production.

The Agriculture and Food Board took over all subsidy payments in 1943. It continued to make milk subsidy payments until September 1946, winding up its activities in June 1947 when the subsidy on butter was removed, rationing was discontinued and price ceilings were lifted.(2) This resulted in yet another shortage of butter. Market forces then came into play and butter prices quickly increased by 29%. A Parliamentary Committee was established to enquire into the price rise, there were demands that the sale of margarine be permitted, and the federal government itself sent the Dairy Industry Act, section 5a, which imposed a ban on margarine sales, to the Supreme Court to test its validity.(3) In 1948, the Court, ruling in favour of the sale of margarine, freed the provinces to pass legislation permitting such sale. All provinces but Quebec and Prince Edward Island did so in short order. The result in the first year of sale, 1949, was an almost immediate 30% drop in the consumption of butter.

The loss in the butter market and the loss of contracts with Great Britain as an export market for cheese caused prices to tumble. The national average farm value of creamery butterfat in 1950 was 22% below the 1948 average.(4) Therefore, in 1948 the Dairy Products Board was authorized to support the price of creamery butter. In 1950, the Board assisted cheese producers by making up the difference between the former

(2) Ibid., p. 56.

(3) Ibid., p. 26.

(4) Ibid., p. 23.

contract price and the Canadian price. The Agricultural Products Board took over these activities in 1951.

The Korean War also affected the dairy industry and policy, albeit in a roundabout way. Milk production declined as many farmers went into beef production to take advantage of an active U.S. market. The outbreak of foot and mouth disease in Western Canada destroyed this market and milk production rose again. Butter stocks began to build up once more. Between 1951 and 1953, creamery butter production increased by 46 million pounds, due in part to the importation of 22 million pounds during 1951-52 when it had been mistakenly believed that there would be a butter shortage. By 1956, butter stocks had reached 91 million pounds and it was necessary to look for export markets. With commodity prices tumbling, the Agricultural Stabilization Board in 1958 was authorized to guarantee the prices of butter and cheese at 80% of the average price realized over the preceding 10 years.⁽⁵⁾ This encouraged butter production to continue unabated while domestic consumption continued to decline. Government authorized the Board to initiate a consumer subsidy on butter in 1962, which somewhat arrested this drop in consumption.

Stocks were also affected by the butter surplus situation in the United Kingdom, which decided to import butter on a quota basis only from regular suppliers, of which Canada was not one. By 1963, there were 238 million pounds of butter and butter oil in storage. By 1966, however, stocks had been reduced to desirable levels due to increased exports, increased population and the federal government's butter subsidy, which was by then incorporated into the deficiency payment plan for milk and butterfat. By 1967, it was necessary to import 2 million pounds of butter.⁽⁶⁾

In the period from the 1950s into the 1960s, methods other than straight subsidy were also used to support dairy products. The "offer-to-purchase" plan permitted the Agricultural Stabilization Board to

(5) Ibid., p. 58.

(6) Ibid., p. 28.

purchase surplus stocks and then sell them at propitious times at cost plus storage fees. The plan was used for skim milk powder as well as for butter and cheese. Subsidies were also provided on manufacturing milk and on casein and caseinates.

From 1951 to 1963, the farm value of milk and cream changed hardly at all. Technological change brought benefits in feeding, breeding and mechanization but resulted in production which was surplus to domestic consumption. This kept prices low but not low enough to make dairy products saleable on the export market without subsidy. At the same time, input costs, particularly for the purchase of modern technology, rose dramatically. By 1965-66, production had settled down to a level approximately in balance with total consumption and with the butter subsidy still in place.

Another change that had a major effect on the structure of the dairy industry as a whole during this period was the new concentration in processing and manufacturing plants and in the retail outlets. Because modern plants are only cost-efficient if they are handling large quantities of milk, many small dairies and cheese plants went out of business. The growth of large grocery chains removed many of the small competitors and "concentrated the retail outlets for milk and dairy products into fewer and fewer buying groups who, in turn, purchased their product from the large dairy plants, where they were assured of a sufficient amount of product." (7) Profit margins were reduced all around.

B. The 1960s and Beyond

Throughout the 30 years of government intervention in the dairy industry, there had been little attempt to encourage structural adjustments within the industry. There was no long-run policy. The Federal Task Force on Agriculture stated in the early 1960s that technology

(7) Ibid., p. 30.

on dairy farms was "appallingly out of date". The Task Force also associated the industrial milk sector with poverty in agriculture.(8)

National decisions concerning the industry had been taken on an ad hoc basis with little regard for its structure or long-term viability. Policy appears to have had three major thrusts: low consumer prices, fulfillment of commitments to Great Britain, and, what appears to have been a less important goal, stable producer prices. There was no mechanism to control supply responses to federal policies, leading to the "boom and bust" in production over the years. Another stumbling block to consistent policy-making was the lack of coordination between the federal and provincial governments. There was tacit agreement among the provinces that provincial self-sufficiency in fluid milk production was desirable(9) and they provided their own subsidies in disregard of and in addition to federal initiatives. This had an effect on total milk production. As pointed out in the Biggs-Lavigne Report of the Review Committee on a Long-Term Dairy Policy for Canada, "In addition to this lack of federal-provincial coordination, it was soon apparent, in the presence of increasing surpluses of industrial milk products, that a program of unrestricted price support was unacceptable".(10)

A "National Authority" was recognized as the solution for regulating the market for industrial milk. The Canadian Dairy Conference was held in February 1963 to explore ways of improving policy coordination. Decisions were taken there that eventually resulted in the Canadian Dairy Commission (CDC), legislated into existence in 1966 with operations starting in April 1967. The CDC became the administrator of the National Dairy Policy.

At that point there was no real policy statement except as embodied in section 8 of the Canadian Dairy Commission Act:

(8) D.L. Macfarlane and L.A. Fischer, Canadian Dairy Industry: Short-Term Perspectives, Food Prices Review Board, Ottawa, 1974, p. 89.

(9) Benoit Lavigne and Everett Biggs, Report of the Review Committee on a Long-Term Dairy Policy for Canada, A Report to the Honourable John Wise, Minister of Agriculture, Toronto, 1986, p. 3.

(10) Ibid., p. 4.

The objects of the Commission are to provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment and to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality.(11)

The CDC undertook the administration of the price support programs and of subsidy payments to industrial milk producers. In addition, it was given jurisdiction over interprovincial and export trade. Its most important powers, however, were those over the manufacturing milk industry. The program at this time did not apply to fluid milk producers. These powers gave the CDC control over the Subsidy Eligibility Quota, the essence of the CDC program. For 1967-68 each producer was allotted a subsidy quota for the coming year equal to his deliveries of industrial milk or cream in the previous year. This was the first time that subsidies to the dairy industry had had any relationship at all to market requirements. Over-quota penalties were introduced, as was a "holdback" from subsidies to aid in the export of skim milk powder. In 1968-69, producers of less than 12,000 pounds of milk were not allotted subsidies but received a payment to assist them in phasing themselves out of the industry.(12)

Payments based on the Subsidy Eligibility Quota for manufacturing milk were made between 1967-68 and 1974-75. In January 1971, the Interim Comprehensive Milk Marketing Plan was agreed to by the CDC and the provincial milk marketing agencies of Ontario and Quebec. Some problems had yet to be overcome. Where pooling systems were used, in Ontario and British Columbia, shippers of manufacturing milk could also participate in the fluid market, and were eligible to receive the federal subsidy on a portion of their non-fluid sales.(13) In other provinces,

(11) Canadian Dairy Commission Act, section 8.

(12) Macfarlane and Fischer (1974), p. 90.

(13) M.M. Veeman and T.S. Veeman, The Impact of Federal Dairy Policies and Provincial Milk Boards on Canadian Consumers, Canadian Consumer Council, 1974, p. 35.

milk which was surplus to fluid milk usage entered manufacturing channels and was indirectly supported by the storage, export and purchase operations of the CDC, without being subject to its control. In order to eliminate these aberrations in its programs, the CDC set out to change the basis for the subsidy from a farmer's previous production for manufacturing milk to the market share for manufacturing milk and cream shipped by either manufacturing or fluid milk shippers. This institutional problem did not approach resolution until 1974 when all provinces, with the exception of Newfoundland, had entered into a Comprehensive Milk Marketing Plan to institute supply management for industrial milk and cream and subsidies began to be paid only on Market Sharing Quota (MSQ).⁽¹⁴⁾ MSQ, by eliminating much of the surplus, had an almost immediate positive effect on producer returns.⁽¹⁵⁾ The MSQ continues to be administered by the Canadian Milk Supply Management Committee.

1. Dairy Policies, 1975 and 1981

The next significant development was the first long-term national dairy policy, adopted in 1975. Its central feature was the industrial milk Returns Adjustment Formula. This formula became the basis for adjusting target returns to industrial milk and cream producers in such a way as to provide efficient producers with the opportunity of obtaining a fair return for their labour and investment.

The policy adopted in 1975 was never entirely put into practice. Extreme financial pressures on the industry, caused primarily by production 18% in excess of Canadian requirements, and large stocks of dairy products in other dairy-exporting nations, caused the modification of a number of the policy's objectives and planning factors:

(14) Ibid., p. 36.

(15) Commission of Inquiry Into Certain Allegations Concerning Commercial Practices of the Canadian Dairy Commission, the Hon. Mr. Justice Hugh F. Gibson, Commissioner, Ottawa, 1980, p. 22.

- Self-sufficiency: Cheese import quotas were lowered from 22.7 thousand tonnes in 1975 to 20.4 thousand tonnes in 1978 where they have since remained. This represented 9.9% of total consumption in 1984/85 as opposed to 14.2% when the quota was established in 1975.
- Level of direct federal subsidy support: The actual level of subsidy has remained the same at \$6.03 per hectolitre despite the call for the level of federal support to be gradually replaced by higher product support prices. In 1975, a ceiling was set on the volume to be subsidized. It was set at 100 million cwt. in 1975-76 and initially at 95 million cwt. for 1976-77. The volume had to be changed upward later in the year. Since that point, the direct subsidy has been payable on all shipments within quota up to the level of domestic requirements, without establishing a ceiling.

Direct subsidy was paid on production under export quota established in 1979. This subsidy was eliminated in 1985.

- Supply management: Aside from the yearly adjustments in quotas to bring them into line with requirements, the major changes involved the handling of surplus production for export. 1977-78 saw the introduction of the butterfat exchange program. Under this program, the CDC exported or assisted the export of whole milk products, receiving a higher price than it would have done for the component parts, skim milk powder and butterfat, and then reimported butter at low world prices. This provided a net gain on sales and did not fully meet domestic butter requirements.
- In 1978-79, an additional refundable levy was imposed to pay for all export costs of surplus products. The levy was eliminated in 1980-81 due to operational problems.
- Supply was affected by the change in the dairy year in 1978-79 from an April 1 to March 31 basis to a new basis of August 1 to July 31 annually. This was done to facilitate more milk production in the winter months, as the new basis gave producers ample quota to produce freely during this period without fear of producing above their annual quota.

- Returns Adjustment Formula: In 1979 the provision for triggering the formula was changed from a 4% to a 2% increase in the target return. It was then stipulated that there could be only two interim adjustments each year, and that they must be at least three months apart with no changes during the months of November and December.
- Impact of price increases on consumers: Because the prices of industrial milk products have largely been determined by increases in the support prices which, in turn, are based on input price increases and the Consumer Price Index, they have increased at the same rate as inflation. A major price change took place when the government chose to eliminate the subsidy on skim milk powder in 1978.(16)

The Interdepartmental Committee on Dairy Policy Review, in 1980-81 culminated in a generally positive position on the National Dairy Policy but at the same time determined that there were three issues which had to be considered:

1. the level of government expenditures on the program was unjustified or excessive;
2. Canada might profitably contract the size of its dairy industry by a substantial amount by substituting imported butter for domestic production; and
3. industrial milk was being overpriced.(17)

The Dairy Farmers of Canada (DFC) refuted the arguments put forward by the Review Committee, stating that:

1. government expenditures were declining in real terms;
2. substituting imported for domestic butter would be "destructive, unfair and ultimately self-defeating" to the industry in Canada as well as being subject to an unstable supply; and

(16) The Interdepartmental Committee on Dairy Policy Review, The Dairy Policy Review, Background Paper No. 2, Dairy Program: Historical Development, Ottawa, 1981, p. 14, 17.

(17) Submission on the Dairy Policy Review, Dairy Farmers of Canada, Ottawa, 23 March 1981, p. 2-3.

3. the contentions about the over pricing of industrial milk made in one of the background documents to the Discussion Paper were insupportable.(18)

In general, DFC believed that the review proved conclusively that there was no justification for a serious attack on or overhaul of National Dairy Policy. What DFC was looking for was further assistance with exports, research and production recording, and particularly an adjustment to target returns to put them in line with increasing input costs. As a result of the review and subsequent deliberations, Price Waterhouse was engaged by the CDC to conduct a cost-of-production study as a basis for altering the target price. Before the study could be seriously considered, however, the federal government imposed its anti-inflation "6 and 5" program, effectively halting any attempt to alter the adjustment formula. The extension of the "6 and 5" program in March 1984 for an additional year (with increases held to 4%) meant that dairy policy was practically frozen from one review to another.

There was very little activity during the period from 1982 to 1985, the most important event being the withdrawal of the British Columbia Milk Marketing Board from the Canadian Dairy Program in 1983.

British Columbia dairy farmers produced primarily fluid milk. Because of the seasonality of milk production, they did require some Market Sharing Quota for industrial milk. For some years, the B.C. Board had expressed the need for a greater share of the national MSQ allotment to utilize the excess fluid production in the summer season.

In 1982-83, the B.C. Board determined that the MSQ requirement was 35 hectolitres of industrial milk for every 65 hectolitres of fluid milk. The Board also wanted recognition of population and market growth within the national policy of quota allocation. After negotiating unsuccessfully with the other members of the CDC for a larger MSQ and greater flexibility in the National Plan, it chose to withdraw from the program. B.C. was not alone in its complaints. Nova Scotia and the three Prairie Provinces have from time to time expressed dissatisfaction with

(18) Ibid.

eventually have the 65/35 principle accepted by the CDC members and made some arrangements concerning market growth.⁽¹⁹⁾ It returned to the CDC in 1985.

Some adjustments were made to the dairy policy during 1984 and 1985. The Canadian Dairy Commission Research Program funding provided by the Government of Canada of cost-of-production data for Ontario, Quebec and New Brunswick was eliminated in November 1984 for 1985. Research funding for product and market research also ended in that year. The federal government cut its subsidy on dairy exports in half, beginning in the 1985-86 dairy year.

2. Dairy Policy, 1986

In the summer of 1985, the Hon. John Wise, Minister of Agriculture, to whom the CDC reports, appointed Mr. Everett Biggs and Mr. Benoit Lavigne to evaluate the elements of the then current dairy policy with a view to incorporating their findings into a new, long-term dairy policy for Canada. After consulting widely, Biggs and Lavigne recommended that the current policy structure remain intact and that "the following components of the policy not be significantly disturbed at this time".

- 1) - The Canadian Dairy Commission should remain as the body responsible under the conditions of the Statute, for the administration of the National Dairy Policy.
- 2) - The subsidy of \$6.03 per hectolitre payable to producers should continue.
- 3) - The Canadian Dairy Commission butter and skim milk powder purchase program appears to work in the best interests of the industry and the consumers.

(19) Dairy Farmers of Canada, Report and Recommendations of the Dairy Farmers of Canada Study Group re British Columbia's Withdrawal from the National Milk Marketing Plan, Edmonton, January 1984, p. 3.

- 4) - A continuation of the supply management program as presently conceived is essential for the preservation of a stable dairy industry.
- 5) - Import controls should be maintained in order to support the supply management program.
- 6) - The supply management program, which is mainly directed at domestic self-sufficiency, should continue to be defined in terms of butterfat requirements.(20)

They recommended that:

- 1) - the government consider the elimination of Treasury commitments to the Special Export Program.
- 2) - the government attempt to further restrict cheese imports either through a reduction of the total quota or a more selective approval of import permits for varieties of cheese which can be adequately supplied from Canadian sources.
- 3) - the government consider transferring the following Treasury costs to the market:
 - (a) the storage, handling and miscellaneous costs associated with the butter purchase program (\$5.364 million in 83/84);
 - (b) the interest payable to the Canadian Dairy Commission from the Government of Canada (\$14.138 million in 83/84); and
 - (c) freight charges associated with the butter purchase program (\$4.890 million in 83/84).

A certain portion of these costs are currently borne by producers (\$3.792 million in 83/84). Should all of these costs be transferred, Treasury savings would be in the order of \$20.6 million. If Treasury contributions towards the Special Export Program were also eliminated, total savings would approach \$27.23 million.(21)

The report also came to conclusions concerning changes required in the operations of the CDC import controls and the Returns Adjustment Formula, recommending that:

(20) Lavigne and Biggs (1986), p. i.

(21) Ibid., p. i, ii.

- the CDC give greater priority to the use of the private trade in export sales.
- the Consultative Committee work more closely with the Consumers' Association of Canada on their concerns about pricing and returns.
- the Returns Adjustment Formula introduced in 1975 is no longer adequate; consequently, a new pricing mechanism be developed after hearings are held by a neutral party.
- blends, e.g., sugar and skim milk powder, where skim milk powder does not exceed 50% of the content, are not covered by import restrictions. Imports of skim milk powder are restricted. As it is believed that pure skim-milk powder presently being used could be replaced by imported blends, controls should be put in place to protect the Canadian industry.(22)

The Government did accept some of the recommendations but in the end retained the policy almost intact. The "new" long-term dairy policy was announced in January, 1986.

- The federal government will continue to provide a subsidy of \$6.03 per hectolitre for industrial milk for domestic use and for up to 1.1 million hectolitres destined for the Special Export Program.
- Producers will continue to be responsible for all export losses.
- The Canadian Dairy Commission is authorized to continue to support market prices for butter and skim milk powder through its offer-to-purchase programs.
- Federal funding for costs associated with buying, storing and marketing butter through the Canadian Dairy Commission will be eliminated.
- The Returns Adjustment Formula will be reworked during 1986 to establish a new formula.
- The CDC's export marketing practices will be reviewed to ensure that private sector exporters can participate in the dairy export trade.

(22) Ibid., p. ii, iii.

- The Import Control List will be altered in order to control the import of dry blends of dairy products (At present, the List does not include dry blends and they are being used to erode Canada's dairy import controls.)
- The Minister for International Trade will press for improvements in Canada's balance of trade in cheeses during the next round of GATT negotiations.(23)

Reaction to the policy statement was generally positive, due in large part to its close adherence to the previous policy. The major source of dissatisfaction was the change in the treatment of the carrying charges for butter. Dairy farmers saw the transfer of the charges to themselves as erosion of their financial returns. This policy will remain in effect until 1991 when dairy policy will be reviewed again.

THE PLAYERS

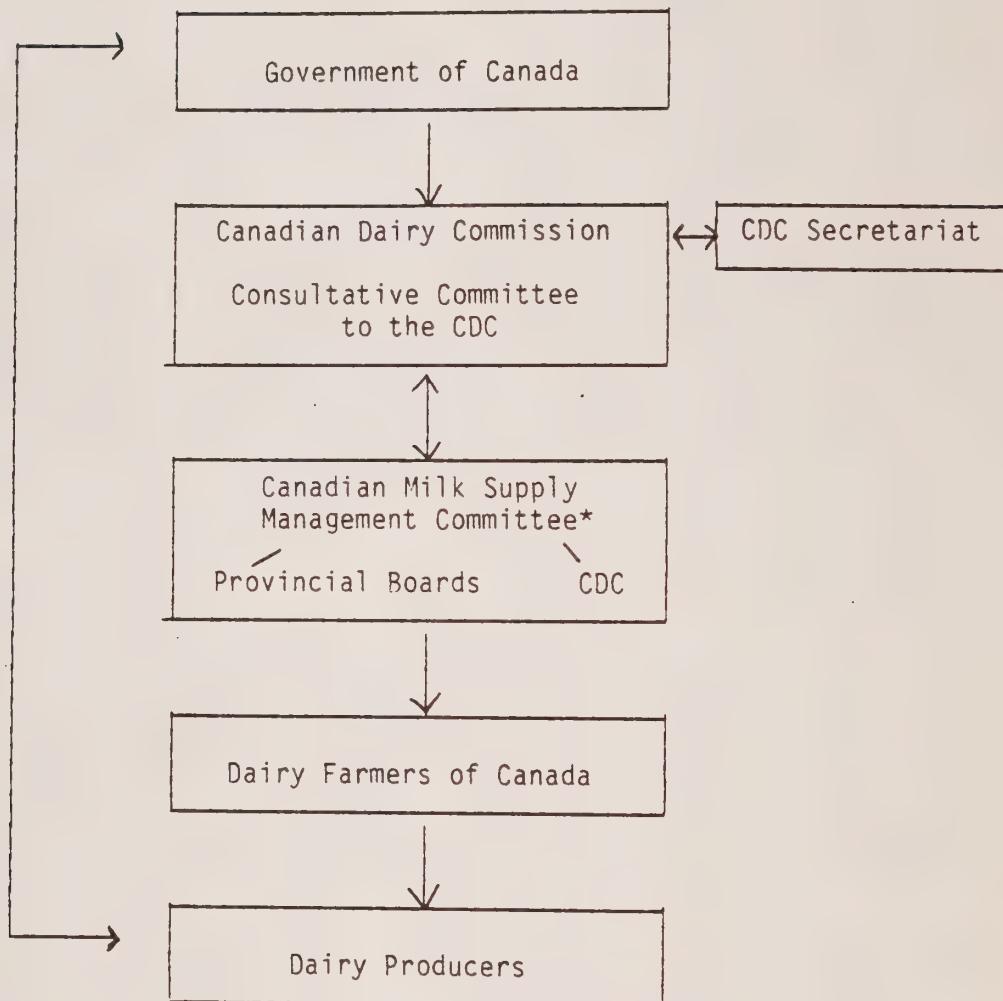
Dairy policy, supply management and the marketing of milk products in Canada are managed through a system designed to provide all sectors concerned, producers, processors and government, with the opportunity to work with each other for the good of the dairy industry.

As can be seen from the chart provided, (p. 18), the system involves a number of agencies, some of which have administrative functions and some advisory functions.

Dairy policy is created and controlled through a hierarchical system involving all the players in one way or another. The system is not laid down in law or regulation except that the federal government is legally responsible for the Canadian Dairy Commission which reports directly to the federal Minister of Agriculture and receives funding from government. The CDC itself is responsible to the Dairy Farmers of Canada, the producers' organization, which, in turn, is

(23) Agriculture Canada, Long-Term Dairy Policy Ensures Continued Stability of Industry, Press Release, 3 p., January 22, 1986.

DAIRY POLICY FORMULATION STRUCTURE



* Dairy Farmers of Canada, Dairy Bureau of Canada, and National Dairy Council also participate in an unofficial capacity.

responsible to its membership. To come full circle, government is responsible to producers as voters and attempts to be responsive to them as business people with business concerns.

A. The Canadian Dairy Commission

According to its annual report the Canadian Dairy Commission has the following objectives:

- to provide efficient producers of milk and cream with an opportunity of obtaining a fair return for their labour and investment; and
- to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality.
- To achieve its objectives, the Commission has the authority to:
 - purchase, store, process or dispose of dairy products in any way it deems appropriate;
 - make payments for the benefit of producers for the purpose of stabilizing industrial milk and cream prices;
 - investigate matters pertaining to the production, processing and marketing of any dairy products;
 - help promote the use of dairy products;
 - receive funds to dispose of dairy products.

The CDC is provided with advice on domestic marketing by a nine-member Committee appointed by the Minister of Agriculture. The Consultative Committee to the Canadian Dairy Commission includes representatives from consumers, retailers, processors and farmers. It is involved in such policy decisions as the CDC's butter purchase and payment program. The Committee's role is truly consultative, as it has little actual power.

The major activities of the CDC include:

- Policy-development and recommendation to the Minister of Agriculture of annual National Dairy Programs and positions on other dairy-related issues, such as import and export policy for dairy products;
- Milk Pricing - calculation of the national target returns level or target price for industrial milk using the Returns Adjustment Formula and the required support prices for butter and skim milk powder;
- Price Support - administration of a federal offer-to-purchase program for butter and skim milk powder;
- Subsidy - payment of subsidy on eligible milk and cream shipments monthly to some 45,000 farmers across Canada;
- Supply Management - chairing of the Canadian Milk Supply Management Committee, monitoring national supply and demand of manufactured dairy products and coordinating the system for national supply management of industrial milk production by the nine milk producing provinces;
- Cost Recovery - calculation of costs associated with marketing surplus dairy products by the Commission and determination of levy amounts to be collected by provinces from producers to finance these costs.
- Marketing - exporting surplus dairy products not needed for domestic consumption, providing export assistance and administering other marketing and promotion programs.(24)

The management of supply and marketing of primary dairy products milk, skim milk powder, etc. is accomplished directly by the CDC through the CDC Secretariat and the Canadian Milk Supply Management Committee with consultation with the Dairy Farmers of Canada (the producers' organization) the Dairy Bureau of Canada (the promotional body for the industry), and the Dairy Council of Canada (representing the processing industry).

(24) Canadian Dairy Commission, Annual Report, 1984-85, Ottawa, 1986, p. 8 and 9.

B. Canadian Dairy Commission Secretariat

The Secretariat is chaired by the Chairman of the CDC and includes the Chief Economist of the CDC, and representatives of the provincial milk marketing boards and the Dairy Council. The Dairy Bureau of Canada and the Dairy Farmers of Canada also have the right to attend the meetings of the Secretariat and to participate although they have no official voice in the proceedings. The Secretariat is responsible for developing a proposal for the amount of quota to be allotted across the country. The proposal is based on consumption projections for the coming year which are based on an econometric model manipulated by Agriculture Canada. It includes requirements for the domestic market, the Special Export Program and the "sleeve", an extra amount to provide production flexibility. This proposal is presented to the Canadian Milk Supply Management Committee as a recommendation.

C. Canadian Milk Supply Management Committee

The Canadian Milk Supply Management Committee (CMSMC) manages the production of industrial milk and cream in Canada in relation to market demand. Its members include representatives of provincial producer marketing boards and the CDC. The president and Executive Secretary of the Dairy Farmers of Canada are ex-officio members. A member of the CDC chairs the meetings. The Committee administers the National Milk Marketing Plan using a system of Market Sharing Quota (MSQ) to distribute production among the provinces. MSQ is also used as a basis for collecting levies programmed to finance export marketing costs. The policies developed by the CMSMC are subject to CDC approval because they form the basis of the federal government's subsidy payments for which the Commission is responsible to Parliament.

D. National Dairy Council

The National Dairy Council is the trade organization of dairy processors. Among its activities for enhancing the position of dairy processors, the Council acts as "coordinator between the dairy processing industry and other organizations in marketing and in other fields". The Council also acts as a lobby group for the processing industry with government and other relevant organizations including the CDC, DFC and the Dairy Bureau of Canada. Another major activity is the maintenance of international contacts to keep members informed of international developments of significance to the Canadian industry. The Council has existed in its present form as a processors' organization since 1936. Prior to that time the National Dairy Council of Canada included producers, processors and distributors of milk and dairy products and its aim was to consider and advance all matters relating to the improvement of the dairy industry in Canada. In 1936, the producer organizations chose to combine to represent their own particular interests and created the Dairy Farmers of Canada.(25)

E. Dairy Farmers of Canada

The Dairy Farmers of Canada is the national federation of organizations of Canadian milk producers. It was established in 1934 as the Canadian Federation of Dairy Farmers which was a member of the National Dairy Council until 1936 when producers and processors chose to go their separate ways. Each province is represented by its own Marketing Board or Producers' Association.(26) The chief function of the DFC is to provide a unified voice for all dairy producer organizations with the purpose of improving the position of the industry through improved policies and legislation and improved marketing policies and strategies, provincially, nationally and internationally. DFC also works with processors and

(25) McCormick, (1968), p. 185.

(26) Ibid., p. 186-187.

distributors to promote the overall welfare of the industry. As mentioned above, DFC has ex-officio representation on the CDC Secretariat and the Canadian Milk Supply Management Committee. DFC is supported by a check-off on quota sales.

F. Dairy Bureau of Canada

The Dairy Bureau of Canada was created as a separate body in 1964. As the marketing arm of Canadian dairy producers, the Bureau came into being as the Publicity and Public Relations Division of the Dairy Farmers of Canada, became the Dairy Foods Service Bureau in 1951 and was formally separated from the DFC in 1964 under its present name.(27) The Bureau sees its responsibility as being to stimulate the consumption of dairy products. Although its primary activity has to do with butter and cheese, it is also involved with overall marketing to the consumer, education, product development and advertising. The Dairy Bureau of Canada is also supported by dairy producer levies collected on a per hectolitre basis by provincial marketing boards or producer associations.

G. Provincial Milk Marketing Boards

The role of provincial Milk Marketing Boards is two-fold:

On the national level, provincial milk marketing boards are representatives of the provinces on the CMSMC, which has jurisdiction over the National Milk Marketing Plan, the framework for the marketing of industrial milk in Canada. Through their participation in the CMSMC, provincial boards are responsible for estimating the Canadian demand for dairy products on a butterfat basis and thereby, establishing the national Market Sharing Quota (MSQ). They are also involved in pricing policy, the collection of levies and of carrying-charges for butter (New Dairy Policy),

(27) Ibid., p. 190-191.

the promotion of dairy products through the Dairy Bureau of Canada as well as in import controls and exports of dairy products. In fact, on the national level, the provincial marketing boards together provide the basis of the supply management system for industrial milk in Canada.

On the provincial level, provincial milk marketing boards are responsible for the distribution of their respective allocations of the MSQ among their dairy farmers and the management of the levy program. Their major role, however, is to develop dairy policies for their fluid milk markets. Each provincial milk marketing board is responsible for its own fluid milk quota, the provincial pricing of the fluid milk, the promotion and the quality of the product and research activities. As representatives of dairy farmers in the provinces, marketing boards work to develop appropriate provincial strategies and to bring them forward to the federal government through their national organization, DFC. As such, the provincial milk marketing boards are an essential component in provincial as well as national milk marketing.

THE ECONOMIC STRUCTURE OF CANADIAN DAIRY POLICY

The Canadian system of milk-supply management on which the National Dairy Program is based is not only unique but is also the most complex economic model in the Canadian agriculture sector. Many analysts agree that the formulation of the Program has led to a structure so complicated that its basic principles and mechanisms are extremely hard to grasp, though this does not prevent them from being extremely effective. Economically, the Dairy Program's greatest success has been to stabilize an industry highly vulnerable to cyclical fluctuation, by integrating provincial production into a national framework. Supply management takes into account the needs of milk producers, processors and consumers all over Canada.

It should be stressed that the milk-supply management system operates at both the federal and provincial levels, but that the use to which the milk is ultimately put determines which level of government has

jurisdiction and sets pricing policies. Milk intended for the consumer market comes under provincial jurisdiction, because it is normally produced and consumed in the same province. Milk intended for the industrial market, that is, for processing into butter, skim milk powder, cheese, ice cream, yogurt and other dairy products, comes under federal jurisdiction. The consumer milk market accounts for about 37% of Canada's total production and the industrial market for the remaining 63%.

Although the National Dairy Program, being federal, affects only the industrial milk market, indirectly it enables the provinces to stabilize their internal consumer and industrial markets.

A. Returns Adjustment Formula

From an economic standpoint, the Returns Adjustment Formula is the cornerstone of the National Dairy Program. It was brought in by the federal government in 1975, after the introduction of the supply management plan. During those five years, producers realized there was a need for a formula that would relate returns to the cost of production while at the same time stabilizing the price of dairy products. The resulting Formula has become the main instrument for self-regulation by the producers, since, along with quotas, it makes it possible to balance Canadian milk-product requirements while providing producers with reasonable incomes.

Although the Returns Adjustment Formula is currently under review, it has not been changed since its introduction in 1975. Table 1 gives details of the Formula's components and their weighting. The three main elements are:

- a) 45%: index of dairy cash input prices, which makes it possible to evaluate the inherent costs of milk production. In 1975, when the Formula was introduced, costs were estimated to be \$11.25 per hectolitre.
- b) 35%: Consumer Price Index, indicating variations in return to producers and family labour. In 1975, this was estimated at \$8.75 per hectolitre.

c) 20%: The producers' capital investment costs. Set at \$5.00 per hectolitre in 1975, this element is not indexed, and has not been adjusted since that time.

The Formula establishes the target national rate of return -- or the support price projected by the federal government -- for industrial milk in Canada, by indexing the 1975 base price of \$25.00 per hectolitre. The Formula is indexed quarterly, so that the appropriate changes can be made in the projected rate of return.

Table 1
COMPONENTS OF THE RETURNS ADJUSTMENT FORMULA

A) 45% Index of Cash Input Prices

<u>Cash Costs</u>	<u>% Weights</u>
16% dairy ration	13.4
Other materials and services index (veterinary medicine, other livestock expense, misc. haulage and fees)	7.8
Hired farm labour	6.6
Machinery repairs	3.1
Fertilizer	3.1
Property taxes	2.8
Petroleum products	2.0
Seed	1.9
Electricity	1.9
Building repairs	1.4
Artificial insemination	0.6
Custom work	0.4
Total Cash Cost Items	45.0%

B) 35% Consumer Price Index (1981=100)

C) 20 % Judgmental factor used to reflect producers' investment costs. It has remained at \$5.00 per hectolitre as set in 1975 and is not indexed.

1) The \$25.00 per hectolitre announced for 1975 is used as the Base Return.

Source: Canadian Dairy Commission, Annual Report.

1. Support Price Structure

The Formula is the hub around which the support price structure functions. The federal government authorizes the Canadian Dairy Commission to administer a program of price supports for dairy products, so that producers can earn the target return. The program includes an offer to purchase butter and skim milk powder at support prices.

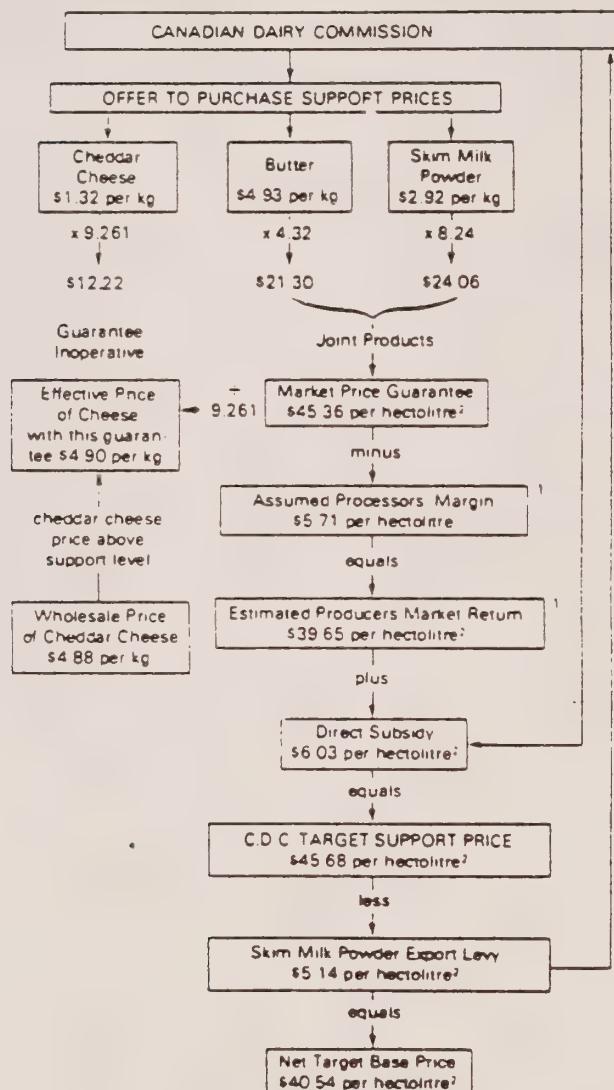
The agreed-to support prices, minus a profit margin for the processors that enables them to cover the costs of processing bulk milk into butter and powdered skim milk, generate a market price that, added to the \$6.03 federal subsidy, enables producers to earn the target return on their product, as established by the Formula. Table 2 shows how the industrial milk price support system works.

The current federal policy prefers to limit changes in price levels to three during each dairy year, including any changes made on August 1, when the dairy year starts. There must be an interval of at least three months between price changes, and no change may be made in October, November or December, when the consumption and marketing of dairy products are at their height. The support prices for butter and milk powder are not adjusted unless the projected rate of return as calculated through the Formula's quarterly indexations is at least 2% higher than the target return established at the beginning of the dairy year. This is commonly known as the 2% trigger effect. Table 3 shows how support prices have evolved over the 1974-1985 period.

The Canadian Dairy Commission's (CDC) support price structure makes it possible to establish floor prices that influence the prices of all dairy products in Canada. The provincial marketing boards and agencies establish the price bracket that processors must pay for various uses of industrial milk, but they do so on the basis of the prices set by the federal government; hence the name "National" Dairy Program.

Table 2

THE INDUSTRIAL MILK SUPPORT PRICE SYSTEM
EXPLAINED DIAGRAMATICALLY,
AUGUST 1, 1985 PRICES



¹ Processors margin inferred only from target support level and offer-to-purchase guarantee. Actual level of producer returns not directly guaranteed and can vary.

² 3.6 kg. butterfat per hectolitre

Table 3

WHOLESALE AND SUPPORT PRICES FOR BUTTER,
SKIM MILK POWDER AND CHEDDAR CHEESE 1974-1985

Year	Creamery Butter			Skim Milk Powder			Cheddar Cheese		
	Ave. Whsle price ^a	Jan. 1	Support price ^b	Aug. 1	Ave. Whsle price ^c	Jan. 1	Support price ^b	Aug. 1	Ave. Whsle price ^b
----- cents per kilogram -----									
1974	174.2	156.5	169.8	187.4	112.2	83.8	110.2	119.0	187.6
1975	228.2	198.4 ^d	198.4	227.1 ^d	136.5	130.1 ^e	130.1	140.1 ^d	227.1
1976	255.5	227.1	238.1	238.1	147.5	140.1	149.9	149.9	242.8
1977	270.9	238.1	260.1	260.1	154.8	149.9	154.3	154.3	259.3
1978	292.1	260.1	280.0	280.0	162.0	154.3	163.1	163.1	277.3
1979	321.9	291.0	302.0	313.0	178.6	172.0	178.6	184.1	306.4
1980	363.7	313.0	334.0	351.0	203.8	184.1	201.0	213.0	350.0
1981	407.4	363.0	378.0	395.0	229.8	220.0	228.0	237.0	393.3
1982	451.1	413.0	417.0	433.0	247.3	246.0	250.0	259.0	432.9
1983	480.8	438.0	442.0	455.0	267.9	261.0	265.0	272.0	456.0
1984	507.5	460.0	471.0	478.4	280.4	274.0	279.0	285.0	479.6
1985	—	478.4	478.4	492.9 ^c	—	285.0	285.0	292.2	322.3

^aFirst Grade, Montreal

^aeffective Jan 24 1975

^bFirst Grade, Montreal, bags

^beffective July 1 1975

^cOntario coloured, prices at Belleville

^ceffective Aug 16 1985

^dSources: Agriculture Canada announcements of support levels

Agriculture Canada, Dairy Produce Market Report

Source: Dairy Farmers of Canada, Dairy - Facts and Figures at a Glance, Ottawa, 1985.

In addition to playing an important role in the stabilization of the price of dairy products, the CDC's offer-to-purchase program helps to keep abundant supplies of fresh dairy products available all year round. The CDC manages this by keeping enough butter in storage for resale to the market when necessary, particularly during the winter months when milk production is lower than in the summer.

Finally, although there is a support price of \$1.32 a kilogram for cheddar cheese (see Tables 2 and 3), the CDC considers that the purchase of cheddar to support target returns is unnecessary. That is why the support price is so far below the market price.

2. Direct Government Subsidies

As noted above, the federal government pays a subsidy toward the costs of industrial milk production both for domestic needs and for the Special Export Program. On April 1, 1985, it announced that it would subsidize only 1.1 million hectolitres of the milk production intended for export, down from 2.2 million hectolitres.

In 1984-85, the subsidy rate remained \$6.03 per hectolitre, the same as when it came into force in 1975. Proportionately, however, this rate in 1984-85, represented only 13.4% of target levels of return, whereas in 1975 it had represented 24%. The milk producers have been trying for several years to get the subsidy rate raised, but when the new long-term dairy policy was announced in January 1986, the federal government maintained the \$6.03-per-hectolitre rate. Table 4 shows the evolution of the direct subsidy and the target support price for industrial milk.

In 1984-85, 44,629 milk and cream producers received subsidies, and cash payments totalled \$284 million, for an average of \$7,549 for each milk producer and \$1,345 for each cream producer.

Table 4

DIRECT FEDERAL SUBSIDY, INDUSTRIAL MILK SUPPORT PRICES,
AND LEVIES, 1974-1985

Year	Direct Federal Subsidy (Apr 1st)	Industrial Milk Support Price			Within-quota Levy ¹	Over-quota Levy ¹
		Jan. 1	Apr. 1	Aug. 1		
- - - - \$ per hectolitre - - - -						
1974	5.22/5.81 ^a	16.26	19.28	21.34	0.34	3.41
1975	6.03	21.34	22.73 ^b	25.00 ^c	1.02	9.08
1976	6.03	25.00	25.97	25.97	3.06	19.52
1977	6.03	25.97	26.90	26.90	2.72	15.89
1978	6.03	27.63	28.17	28.17	2.73 ^d	17.03
1979	6.03	29.35	30.15	31.01	2.95 ^d	18.16
1980	6.03	31.01	33.31	34.61	2.96	18.16
1981	6.03	35.70	36.61	38.06	3.30	17.13
1982	6.03	39.61	39.61	41.02	4.40 ^e	20.21
1983	6.03	41.40	41.66	42.80	5.14 ^f	31.79
1984	6.03	43.18	43.83	44.65	5.14 ^g	34.38
1985	6.03	44.65	44.65	45.68	5.14 ^h	38.00

April 1 1973 1978 Aug 1 1979 1985

^aeffective June 1

^beffective Jan. 24

^ceffective July 1

^dincludes contingency levy to cover excess sleeve production

^eincludes both the sleeve levy and the export quota levy

^f1983

Source: Canadian Dairy Commission

^gincludes export quota levies

^hthe in quota levy varied between \$5.14 and \$6.14 per hl depending on the province, beginning Aug. 1, 1984

^aapplicable to 44 874 mil hl export quota levies at \$29.73 on additional 1 726 mil hl

the over quota levy including sleeve was \$37.70 January 1, 1985

Source: Dairy Farmers of Canada, Dairy - Facts and Figures at a Glance, Ottawa, 1985.

3. Import Controls

So that the various economic mechanisms can function without disrupting the milk supply management system, the federal government is obliged to exercise careful control over imports of a wide range of dairy products.

Under the General Agreement on Tariffs and Trade (GATT), imposing import controls on commodities subject to supply management is a valid and recognized practice (GATT, article XI). Such controls prevent the displacement of significant quantities of Canadian dairy products on the Canadian market, and thus protect [Canadian] producers against losses incurred through having to export all production in excess of domestic demand.

With respect to cheese,(28) Canada has maintained an import quota since 1975, at which time it was 22.7 million kilograms. By 1978 it had fallen to 20.4 million kilograms. Under an agreement with the European Economic Community (EEC), 60% of the quota was allocated to EEC members.

Although restricted by quota, imports of specialized cheese encouraged the development of domestic demand, which has encouraged the growth of a Canadian industry in this sector. Currently, imported cheese represents 9.9% of domestic consumption, down from 14.2% in 1975.

One of the chief demands made by Canadian dairy producers is that cheese imports be restricted still further, and that quotas be set by variety rather than being uniform for all varieties. The debate will be at the level of GATT, which has jurisdiction over import quotas. The present round of GATT negotiations could in principle lead to certain changes in Canadian dairy policy. Already some of the EEC countries have protested that Canada has not lived up to all its commitments on import quotas, particularly the agreement to increase its cheese import levels at the same rate as domestic cheese consumption increased.

(28) Referred to here are specialty cheeses, other than cheddar.

B. Market Sharing Quota

While the Returns Adjustment Formula and support prices are the principal economic mechanisms which form the basis of the federal dairy policy, the central feature of the policy remains the national Market Sharing Quota (MSQ).

1. Balancing Supply and Demand

The Canadian Milk Supply Management Committee (CMSMC), the body responsible for setting industrial milk quotas, works to ensure that Canada is self-sufficient in milk fat. It must therefore meet domestic and export needs. This approach, which makes it possible to adapt production to domestic needs, stands in contrast to the production surpluses recorded by other major milk producing countries such as the EEC members and the United States. In fact, the EEC used the Canadian management system as a pattern when it introduced a quota system of its own in April 1984. It should, however, be noted that, while large surpluses prompted the EEC to establish a quota system, Canada developed its own milk supply management system in order to guarantee a fair level of return for producers and to promote a stable supply of high-quality dairy products for consumers. Surpluses were not a major problem when the system was first introduced in Canada in 1970.

The CMSMC sets the national Market Sharing Quota, which is then allocated among the provinces according to shares which they negotiate and agree to among themselves. In turn, the provinces allocate their respective allotments among their producers, according to their own quota policies. Provincial policies are subject to Canadian Dairy Commission approval as they form the basis of the federal government's subsidy payments. Table 5 shows that Quebec and Ontario were allocated nearly 80% of the total MSQ.

Table 5

MARKET SHARING QUOTAS ALLOCATED TO THE PROVINCES
AND THEIR UTILIZATION IN PERCENTAGE FIGURES, 1983 TO 1985

Province	Date of adherence to plan	Initial quota and special(1) quota	Utilization in August 1 1983	Utilization in percentage 1983/84	Utilization in August 1 1984	Utilization in percentage 1984/85	Utilization in August 1 1985
-millions of kilograms of butterfat-							
P.E.I.	Dec. 1/71	3.18	3.246	99.3	3.212	96.8	3.160
N.S.	Apr. 1/74	1.86	2.164	100.7	2.142	102.0	2.107
N.B.	Apr. 1/74	2.04	2.262	98.8	2.238	101.1	2.201
Que.	Dec. 1/70	89.27	82.233	99.8	81.380	100.8	80.018
Ont.	Dec. 1/70	67.49	53.530	102.3	52.974	101.9	52.135
Man.	Jul. 1/72	8.89	6.693	101.0	6.624	101.7	6.516
Sask.	Jul. 1/72	6.67	4.455	102.8	4.409	101.3	4.337
Alta.	Apr. 1/72	16.33	11.492	98.9	11.373	101.5	11.186
B.C.	Oct. 1/73	5.22	5.302	104.5(2)	6.221	105.8	6.184
Canada			171.377	100.8	170.573	101.3	167.844

1. The special quotas are as follows: P.E.I., 0.23 m; Man., 0.68 m; Sask., 0.41 m; Alberta, 0.86 m. All special quotas were allotted, except in Saskatchewan's case.
2. This percentage corresponds to a production of 6.269 million kilograms of butterfat in relation to the adjusted quota of 6 million kilograms of butterfat. The actual utilization percentage in relation to the national quota is 118.2%.

Source: Canadian Dairy Commission.

2. In-Quota and Over-Quota Levies

The in-quota levy is a key variable in the setting of target returns for milk producers since it determines the net target returns level, that is the actual income received by producers (see Table 2).

The in-quota levy is used to pay the costs associated with exporting dairy products not destined for domestic consumption. The levy covers the costs associated with subsidized cheese exports to England and the United States and with the losses inherent in the special export program for evaporated milk and whole milk powder. However, a substantial portion of the in-quota levy is used to cover the necessary costs of marketing the structural surplus of skim milk powder.

This structural surplus arises from the production of a milk by-product which is crucial to achieving a balance between the supply and demand for milk on a butterfat basis. The production of these by-products, in satisfying domestic requirements for dairy products, results in surpluses of skim milk powder, the worldwide demand for which is declining. The storage and marketing of these surpluses cause a great deal of expense to producers who experience a proportionate drop in their net returns.

Since 1983, the in-quota levy charged has remained at \$5.14 per hectolitre. While it may vary slightly from one province to the next, the financial responsibility of the provinces as a whole is calculated on a uniform basis. The in-quota levy is collected by the different provincial marketing boards which then remit corresponding amounts to the Canadian Dairy Commission on a monthly basis.

Although the specific impact of the MSQ on the price of industrial milk remains unclear, it can be argued that had there been no quota, the government would certainly not have expanded its prices support program to the extent it did under the management system. Had there been no quota, even larger surpluses of skim milk powder would have been recorded, which would have resulted in even higher costs.

That is the situation which now prevail in the United States where the cost of enormous powdered milk surpluses must be borne by the

government and where exports of this product are heavily subsidized, thus depressing world prices even further. As mentioned earlier, the European Economic Community must also deal with substantial structural surpluses and recently opted for a production quota system with a view to controlling these more effectively.

In Canada an over-quota levy is also charged to milk producers. This levy is collected on all surplus production, that is on production which exceeds the levels set by the Market Sharing Quota. The over-quota levy is therefore both an incentive to limit production and a penalty for over production. The payments remitted are used primarily to finance the cost of disposing of surplus production. In 1985, the over-quota levy was set at \$38 per hectolitre. Table 6 shows the total levies remitted by producers in 1984 and 1985.

The sometimes substantial over-quota levies collected, for example \$24 million worth in 1985, make it clear that milk production is an industry that does not always respond to all the control mechanisms imposed on it: first, because production is cyclical, which upsets the balance between supply and demand, and second, because in meeting demand, structural surpluses are inevitable. Research is under way to improve the production cycle and reduce structural surpluses.

In the meantime, production quotas will continue to be the best and most widely accepted way in the industry of controlling the supply of industrial milk in Canada.

C. The Advantages and Disadvantages of the Canadian Milk Supply Management System

Several studies have weighed the advantages and disadvantages of the Canadian dairy policy, with often conflicting results.

Barichello (1982)(29) admits that the dairy policy has encouraged the development of a strong processing industry. The main

(29) Richard R. Barichello, The Economics of Canadian Dairy Industry Regulation, Technical Reports Series - Economic Council of Canada, 1981.

Table 6

LEVIES REMITTED BY MILK PRODUCERS
BY PROVINCE, 1984 AND 1985
(IN THOUSANDS OF DOLLARS)

	In-quota levies		Levies		Total over-quota	
	1985	1984	1985	1984	1985	1984
P.E.I.	3,678	4,027	-	-	3,678	4,027
Nova Scotia	2,977	2,693	468	129	3,445	2,822
New Brunswick	3,122	2,719	248	-	3,370	2,719
Quebec	128,011	115,688	6,686	-	134,697	115,688
Ontario	74,630	67,408	9,780	10,394	84,410	77,802
Manitoba	8,680	7,754	1,070	549	9,750	8,303
Saskatchewan	5,775	5,162	444	980	6,219	6,142
Alberta	16,232	14,426	1,880	-	18,112	14,426
B.C.(1)	7,177	118	3,862	1,371	11,039	1,489
Total	\$250,282	\$219,995	\$24,438	\$13,423	\$274,720	\$233,418

(1) Following British Columbia's decision to rejoin the national marketing plan in November 1984, the province was credited with the unpaid subsidies. The figures for 1984 are therefore not comparable.

Source: Canadian Dairy Commission

advantage for consumers is the guarantee of a stable supply of high-quality dairy products. However, the costs and revenue transfers generated by the system are enormous and benefit primarily the producers, at the expense of consumers. In his analysis, Barichello states that the impact of this policy on consumers is clear: he contends that domestic prices of dairy products manufactured in Canada are often twice as high as international prices. Barichello takes into consideration evolving world and domestic prices, exchange rates, social costs and quota prices and concludes that milk producers benefit from a transfer of \$670 million per year whereas consumers lose about \$680 million. It should be noted that certain hypotheses advanced by Barichello are somewhat farfetched and should therefore be interpreted with reservations.

If we consider solely the question of subsidies paid by the federal government to producers, the transfer is far more modest. From 1980 to 1985, subsidy payments averaged \$276 million per year, whereas levies (dues or payments) remitted by producers to the Canadian Dairy Commission averaged a total of \$219 million per year.

Over the years, the issue of subsidies has tended to mask real increases in producers' returns. Between 1977 and 1984, farm prices increased by 63.5%, while production costs were up 65.8% so that net returns on in-quota production rose by only 58.4%. Moreover, with regard to over-quota production levies, average net returns per hectolitre produced increased by only 45.5% over this seven-year period. By referring to the Consumer Price Index, we can see that the real level of returns on in-quota production actually decreased by 12%. This drop in revenue is even greater, namely 19.3%, in terms of overall production (including over-quota production).⁽³⁰⁾

It is still clear, however, and the various studies agree on this point, that milk producers have faired better than other agricultural producers, primarily because the dairy policy makes for a structured national production system and enables improved long-term planning.

(30) Ontario Milk Marketing Board, Quota Controls on Supplies and Supply Management, Canadian Reply to International Dairy Federation (unpublished data).

Furthermore, as a result of stable supplies, a dynamic processing industry has emerged, one which promotes aggressive marketing techniques.

Where would the Canadian dairy industry be today had it not been for a supply management system? Governments, producers and processors all agree that the dairy industry would be considerably smaller - by 25% it is often said. Had there been no quotas, the volume of imports would have been much higher and producers would not have invested \$20 million per year (the current level) on the promotion of butter and cheese. The dairy processing industry, which employs 15,000 people in 400 plants, each of which processes an average of 18.2 million litres of milk annually, would never have achieved this level of economic importance.

It should also be noted that had there not been a supply management policy, the government would probably not have supported butter and skim milk powder prices. Domestic butterfat requirements would have been met by imports, thus eliminating some of the problems connected with structural surpluses. In short, had there not been a dairy policy, the industry would likely have resorted to a payment system based on non-fat milk components, rather than on butterfat content, as is the current management system.

The idea of a payment system based on non-fat milk components is gaining acceptance throughout the Canadian dairy industry and could lead to major changes in the management of the national dairy policy within the next few years. In fact, it has become one of the long-term goals of milk producers in Canada.

There will always be advantages and disadvantages to a supply management policy, economic and financial costs to be borne along with positive and negative effects. It is up to the individual to weigh the pros and cons. Nevertheless, Canada's dairy policy stands as an international model which an increasing number of milk producing countries are trying to emulate, an indication that it has achieved some measure of success.

ISSUES AFFECTING DAIRY POLICY TO 1991

National Dairy Policy is set to be reviewed again for 1991. During the intervening five years, numerous factors will have a significant impact on the dairy industry and its future. New growth hormones will reportedly enable cows to produce between 20 and 40% more milk than at present. This does not represent a long-awaited breakthrough in efficiency. In 1984, average yields were up 70% from 20 years earlier, so that adjustments in production processes were required.(31) Trade agreements and patterns are changing and the changes will have major impacts on the agricultural industry as a whole. Domestic consumption patterns are being altered because of the increasing emphasis on low-fat foods and, at the same time, a greater interest in cheese will potentially affect the way in which industrial milk is processed and utilized.

There are, in fact, three major issues which will be dealt with before the next Dairy Policy review.

A. Returns Adjustment Formula vs. Cost of Production Model

The present Returns Adjustment Formula was established in 1975. As mentioned previously, it has three components: an index of dairy cash input prices to evaluate costs in milk production accounts for 45% of the final target return, the Consumer Price Index as a measure of changes in the returns to producers and family labour, accounts for 35% and producers' capital investment costs accounts for 20%. Dairy farmers in Canada are becoming more and more concerned that the formula does not reflect the true costs of production, particularly provincial differences. They are also concerned because the Returns Adjustment Formula does not use up-to-date cash costs and, in addition, because appropriate returns to management and equity are not reflected in the formula.

(31) Stephen Strauss, Hormone Use Shaking Milk Industry, *Globe and Mail*, August 16, 1986.

Producers believe that the pricing of milk should reflect accurate and up to date cost of production data and that savings realized through productivity improvements should eventually be passed on to consumers. Dairy Farmers of Canada have made numerous appeals to government and in March 1985, made representation to the Minister of Agriculture, on the basis of its own calculations, that the target price fell \$3.33 below the cost of production. DFC at that point expected that a new base price for industrial milk would be established when the new dairy policy was introduced and that this would reflect cost increases.(32) The fact that no new base price was established will intensify the discussions.

Biggs and Lavigne, in their report, suggested that a public review of this issue be undertaken. In fact, there was speculation that the change would be announced in the new long-term policy for 1986. According to Biggs-Lavigne, consumers see the current price adjustment mechanism as "antiquated and inaccurate".(33) The Honourable John Wise said in his statement on the Long-Term Dairy Policy that the Returns Adjustment Formula would be revised but gave no indication of what form the revisions will take. Considering the concerns expressed by the Nielsen Task Force, Biggs-Lavigne and by the Minister himself that the industry should be better geared to the market, it is inevitable that the formula will be market-oriented.

As a new formula would require new cost-of-production figures, and as the Dairy Farmers of Canada have not been pleased with the cost-of-production calculations made by Price-Waterhouse, it is likely that another firm will be charged with preparing such figures which will be the basis of new negotiations between producers and government.

(32) Dairy Farmers of Canada, letter to the Hon. John Wise, March 18, 1985.

(33) Lavigne and Biggs, (1986), p. 29.

B. Multiple Component Pricing (MCP)

Industrial milk is at present priced according to butterfat content: the higher the butterfat content, the higher the price received by the producer. This tends to undervalue the non-fat solids in milk (protein, lactose, minerals), referred to as solids non-fat (SNF). It also encourages the production of butter and skim milk powder almost as by-products as processors seek to utilize those components which are not useful to them. These products, then, are not priced according to their own true value and are produced in surplus quantity. The current pricing system has also resulted in increasing milk costs per pound of SNF product, particularly cheese. Some factories in the U.S., in states with similar milk pricing systems to Canada's, have found cheese production to be uneconomic and, in some cases, have had to subsidize cheese-making operations from fluid milk sales. This situation undoubtedly also exists in Canada.

Multiple Component Pricing, paying according to the individual components in the milk, would more accurately reflect the value of those components in returns to the producer and to dairy products processors. With patterns of consumption shifting towards low-fat products and to cheese, it is considered that MCP might also include a potential improvement in public acceptance of the industry. MCP will make it easier to recognize changing needs or markets, and to respond to them. By placing less emphasis on butterfat, by providing greater product flexibility, and by fostering "a growing recognition of the importance to the diets of healthy Canadians of other components in milk, especially calcium and protein"(34) the dairy industry could project a more progressive image.

For the past year, the Ontario Milk Marketing Board has shown on receipts to producers, not only returns based on butterfat alone, the traditional pricing mechanism, but also returns based on butterfat and solids-non-fat. (The actual returns are still calculated on a butterfat basis.) These receipts enable producers to compare their returns from the

(34) Ontario Milk Marketing Board, Discussion Paper, Multiple Component Pricing, October 1985, p. 3.

current pricing system with those they would receive under the MCP system. This MCP system has been designed "to return to producers the same total dollars on an annual basis as does the current system at the time of changeover (from one system to another)...from that point on, any increase in SNF beyond what is consumed in the current butterfat differential formula would be paid to producers and charged to processors."(35) The Ontario Board is planning to implement MCP within the next few years.

Dairy Farmers of Canada have discussed MCP and its implications over the past two years. The issues which will have the greatest impact on the industry include a decision on whether the breakdown of MCP will be into butterfat/protein or into butterfat/total solids-non-fat, and the potential impact of MCP on the establishment of industrial milk quotas (MSQ) and levies which are at present determined on a butterfat basis. Although these issues will take some time and effort to work out, the move to MCP is almost inevitable. There has been an upsurge in interest in component pricing in the U.S. because of the American policy to reduce surplus milk, the fact that the value of protein vs. fat is increasing, and because of the development of new products with a higher ratio of protein to fat than exists in raw milk. California, the largest market in the U.S., has had a state-wide Multiple Component Pricing program for 20 years. Wisconsin, a major dairy-producing area, also follows MCP systems. Other countries have also moved to MCP, as Britain did in 1984, or, like New Zealand and Australia, are considering it.(36) To develop an efficient industrial milk production sector and minimize surpluses, MPC may well be the wave of the future for Canadian dairy producers.

C. Trade

Trade in dairy products is an important and sensitive issue. As the new GATT round is set to begin, the Canadian dairy industry

(35) Ibid.

(36) Dairy Farmers of Canada, What the United States Is Doing with Respect to Multiple Component Pricing of Milk, November 1985, 5 p.

finds itself in a somewhat awkward position. Canada has not lived up to the agreement from the last round (Tokyo 1981) in relation to cheese imports. At that time, Canada agreed to an import quota that would move with changes in population and consumption. Sixty per cent of this quota was reserved for the European Economic Community. The Canadian government, under pressure from dairy producers, has not increased the amount of the quota to the levels indicated in the GATT agreement. The EEC, with enormous surpluses of dairy products to dispose of on the export market, has repeatedly complained about Canada's intransigence. Canada therefore finds itself in a position where, while dairy producers represented by DFC call for a 20% reduction in the cheese import quota, the new GATT agreement will likely enforce import levels at least as high as those in the previous agreement. The position is made even more sensitive because the Nielsen Task Force recommended that cheese imports be steadily increased to reduce the amount of milk production required and the resulting surplus skim milk powder that must be marketed at a loss. The Free Trade discussions with the United States will also have an effect. Canada will not want to appear to be overly protective of her domestic market while negotiating major changes in trade patterns. Also, the fact that Canada has recently been very critical of the U.S. for its protectionist stance and its heavily subsidized exports of enormous quantities of cheese, butter and skim milk powder surplus to its own needs, will make the discussions quite delicate.

Free trade in the agricultural sector has been a very controversial issue. Many analysts have expressed different opinions on this matter but all agree that agriculture is a special case. The question is always the same: should agriculture be "on the table" in the Canada-United States trade negotiations?

Canada's policy in agriculture involves a high degree of self-sufficiency, market stability in prices and output and income stability for farmers. The government acts sometimes as a supply manager, sometimes as an import regulator, and sometimes as both, by instituting stabilization and marketing programs, subsidies, quotas, tariffs and other barriers to trade. The National Dairy Policy is a good example of that government intervention.

During the Canadian-U.S. trade negotiations, both countries will have to evaluate their various agricultural programs. For Canada, this will be difficult mainly because of the division of constitutional responsibility for agriculture. There is no doubt that freer trade in agriculture can only be achieved if there is progress on issues involving provincial marketing boards, provincial price subsidies, aids to production, etc.

U.S. negotiators have stated that supply-management programs must be "on the table" but Canada is unlikely to accede to any large scale dismantling of domestic marketing programs. Indeed, the Secretary of State for External Affairs stated in the House of Commons on 23 January 1986:

The government has made clear for some time that it regards the system of marketing boards which is in place in the country as part of the distinctive fabric of the country. We do not intend to change the distinctive fabric of our country.(37)

It is not an easy task to examine the impact of Canadian-U.S. trade on the dairy industry; in addition to the political issues, the economic impacts are also controversial. If there is to be free trade, the National Dairy Policy, the aim of which is self-sufficiency in dairy products, may have to be modified, if not dismantled.

Dairy production represents 15% of total farm cash receipts. Tariffs and non-tariff barriers (NTB) are especially important for dairy products and have meant that imports are nonexistent except for cheese, mostly from the EEC. If free trade means the elimination of tariffs and NTB, this will open the door to American products. For example, inventories of industrial milk in the U.S. are sufficient to meet Canada's needs for up to five years; in 1984, the U.S. surplus of skim milk powder was 560,000 tons, and that for cheese was 481,000 tons. These surpluses could create a significant market-instability and a substantial displacement of domestic production. This scenario does not take into

(37) Canada, House of Commons, Debates, January 23, 1986, p. 10095.

consideration the effect that imitation dairy products would have on the market. Canada would almost surely have to lift its restrictions against mutation dairy products to bring its policies in line with those of the U.S.

In Canada, the National Dairy Policy has been successful in meeting the objectives of agricultural policy, providing market stability in prices and output, and income stability for farmers. It has also contributed to maintenance of a family farm structure, which is not the case in the U.S. A different structure also means different prices and costs.

The Biggs-Lavigne Report provides some information on producers' prices for industrial milk. The conclusion is that the industrial milk price was C \$8.70/hl higher in Canada, at \$44.01, than in the U.S., at \$35.31, in 1984. These figures should be treated with caution because there is some question of the methodology used to estimate them. Another study,(38) by Mr. Yvon Proulx, has also analyzed producers' prices for industrial milk. Mr. Proulx's results are astonishing in the sense that they are totally opposite to the Biggs-Lavigne data. To estimate the price received by producers, Mr. Proulx uses the dairy cash receipts divided by total sales of milk. Although there is no problem with this technique, it is, however, a rather broad approach to estimating the competitive position of the Canadian dairy industry. Mr. Proulx's results show that in 1984 the price differential for industrial milk was only \$0.88/hl to the advantage of Canada.(39) For fluid milk, the situation is different. The U.S. producers are more competitive than their Canadian counterparts with a price differential of \$6.06/hl. Mr. Proulx concludes that, although Canadian producers could be competitive in the industrial milk market, they would most likely lose the fluid milk market and consequently experience a decrease in their revenues. This situation would be catastrophic for many producers.

(38) Yvon Proulx, Le libre-échange et l'agriculture, Report for the Union des producteurs agricoles du Québec, May 1986.

(39) Table 7 presents price differentials for Quebec, Ontario and U.S.

Table 7

MILK, PRODUCERS' PRICES, QUEBEC, ONTARIO AND U.S.
(C \$/hectolitre)

TOTAL MILK

Year	Quebec	Ontario	U.S.
1978	25.04	25.60	24.99
1979	27.39	28.57	29.55
1980	30.36	32.02	34.66
1981	34.46	35.98	37.49
1982	35.94	37.61	38.11
1983	36.87	37.96	38.00
1984	38.79	40.52	39.57

FLUID MILK

Year	Quebec	Ontario	U.S.
1978	28.76	28.58	27.98
1979	30.66	31.80	32.47
1980	34.92	35.81	35.09
1981	39.53	41.20	37.98
1982	42.44	42.23	38.50
1983	44.11	45.84	38.42
1984	46.01	48.91	39.95

INDUSTRIAL MILK

Year	Quebec	Ontario	U.S.
1978	24.06	23.45	25.91
1979	26.49	26.23	31.94
1980	29.09	29.44	32.00
1981	33.05	32.48	34.68
1982	34.21	34.70	35.49
1983	34.80	32.69	35.36
1984	36.82	35.01	36.89

Source: Yvon Proulx, - Le libre-échange et l'agriculture, report prepared for l'Union des producteurs agricoles du Québec, May 1986, p. 105.

The producers' prices presented above are useful in determining one particular impact of free trade, but they are sometimes offset by subsidies and support prices. Costs of production are, therefore, more relevant in establishing the competitive situation between Canada and the U.S.

The United States Department of Agriculture (USDA) and Dairy Farmers of Canada are the principal sources of information on the respective costs of production. It should be noted that the U.S. cost of production calculations for milk are for the cow-herd plus replacements, whereas DFC uses cow herd only. As shown below, some calculations have been done to render the two costs of production comparable.

Table 8 shows the USDA cost calculations for 1984 which give a total cost of US \$13.49 per hundredweight, equivalent to C \$39.62 CDN per hectolitre(40) at the average 1984 exchange rate of US \$1 = C \$1.2948. However, this cost figure represents the total cost for the cow herd plus replacement enterprises, unadjusted for the revenue from the sale of cull cows, calves and replacements. USDA reports this revenue separately, and in 1984 it was \$1.07 U.S. per cwt. (C \$3.14 per hl). The resulting U.S. cost of production is therefore US \$12.42 per cwt., or C \$36.48 per hl.

Dairy Farmers of Canada uses the average cost of production of the 70% of the producers with the lowest costs in three provinces - Quebec, Ontario and New Brunswick - as the basis for its calculation. The cost of production for industrial milk in the fourth quarter of 1984 was \$47.98 per hectolitre, which is \$11.50 above the U.S. cost of production for industrial milk. Although the two calculations are not exactly the same, it must be noted that the DFC calculations rigorously exclude any value or cost associated with the holding of a quota and therefore, it is possible to compare more accurately the U.S. data with the average Canadian cost of production. The gap between the two costs of production can be largely explained by the structure of farms, higher prices of farm inputs in Canada and by the supply-management. Because of this difference in the costs of production, it would be difficult for Canadian milk producers to compete with U.S. producers.

(40) Hundredweight of milk at 3.5% butterfat equals 0.441 hectolitre at 3.6 kg butterfat per hectolitre.

Table 8

U.S. COST OF PRODUCTION FOR MILK 1984

	U.S. \$ per cwt.	C \$ per hl.
Feed	\$ 4.85	\$14.24
Milk Hauling	.34	1.00
A.I.	.12	.35
Vet. and Medicine	.22	.65
Livestock Hauling	.02	.06
Marketing	.11	.32
Fuel, Lube, Electricity	.37	.1.09
Machinery and Bldg. Repairs	.38	1.12
Hired Labour	.87	2.55
DHIA Fees	.05	.15
Dairy Supplies	.19	.56
Dairy Assessment	.50	1.47
General Farm Overhead	.61	1.79
Taxes and Insurance	.34	1.00
 Total Cash Costs	8.97	26.35
 Capital Replacement	1.56	4.58
Return to Operating Capital	.12	.35
Return to Other Assets	1.32	3.88
Unpaid Labour	<u>1.52</u>	<u>4.46</u>
 Total	13.49	39.62
 <u>Less: Revenue from Livestock Sales</u>	<u>1.07</u>	<u>3.14</u>
 TOTAL COST	\$12.42	\$36.48

Source: United States Department of Agriculture, Dairy Outlook and Situation Report, Economic Research Service, March 1986.

In his address at the 1986 Southwestern Ontario Farmers' week, Mr. T.K. Warley⁽⁴¹⁾ estimated that a free trade agreement would reduce Canadian fluid milk prices by 20 to 40% and would cut profits, while industrial prices would fall by 20%.

Should Mr. Warley's predictions come to pass, Canadian dairy producers will be left in much the same situation of price and income instability that prevailed before supply management. A major restructuring of the industry would have to ensue to permit some producers to make adequate earnings.

CONCLUSION

The Hon. John Wise, Minister of Agriculture, in announcing the 1986 Dairy Policy, very little changed from that in place, stated that "when something is working well, you shouldn't tinker with it".⁽⁴²⁾ This sentiment is likely to hold for the 1991 dairy policy also, also with the promise that change will be made where change is needed. National Dairy policy appears to be providing stable markets and fair prices for producers and ensuring consumers continued supply of high quality milk and dairy products at moderate prices.

As mentioned above, two areas are almost certain to be altered by 1991. First, the Returns Adjustment Formula is likely to be modified to make it more closely reflect the costs of production than does the present formula. Second, multiple component pricing (MCP) could be an opportunity to strengthen the industry. MCP, by reflecting more adequately the value of the components of milk, will make milk production more market-oriented. If an MCP system should be put in place there would be

(41) T.K. Warley, What Would Free Trade Mean to Agriculture?, Address at 1986 Southwestern Ontario, Ridgetown College of Agricultural Technology, January 2, 1986.

(42) The Hon. John Wise, Minister of Agriculture, "Agriculture Canada, Long Term Dairy Policy Issues Continued Stability of Industry", Press Release, 3 p., January 22, 1986.

implications for how levies and subsidies, are collected, distributed and calculated, and even for the calculation of the formula.

As pointed out above, the outcome of trade talks, particularly the free-trade talks with the U.S., could have a major impact on the dairy industry as a whole. In Canada, the surpluses of dairy products are controlled, a situation which does not apply in the U.S. or in the EEC. Increasing production to compete is not a solution if there is no market for the products, as is the case. Even if Canada could compete with the U.S., free trade would not automatically create new markets. There would simply be a displacement of the present production and surpluses which, in the long term, could create instability in the industry. Prices might decrease for a while but, in the end, production would increase to make up for the loss of revenue, resulting in greater surpluses. This was the situation before the implementation of supply management in Canada and no one, producers or consumers, is likely to want to see this situation arise again.

Whatever the impacts of free trade may be, they will have to be taken into consideration in the development of the 1991 policy, as will technological advancements, such as growth hormones, although the introduction of these would not have any direct effect on dairy policy per se. Consequences for quota allocation, cost of production, etc., will however, have to be carefully examined and fitted into the existing policy and administrative framework as new technology is put to use on the farm.

A number of papers and reports have been released on the future of the National Dairy Policy. The Nielsen Task Force Reports propose, in one scenario, the inclusion of dairy supply management under the National Farm Products Marketing Council and an elimination of subsidies. It is known that the Biggs-Lavigne Report (Part II) includes recommendations on levels of target returns and the cost of production formula. This particular report is at present being considered by the Minister of Agriculture and it is difficult to gauge the influence that its recommendations will have on dairy policy in future years. Although, as Mr. Wise has stated, the dairy policy appears to be working well, political decisions to change the present system may still result from the recommendations of these reports.

The dairy industry, like other agricultural sectors, is facing the prospect of long-term restructuring if it is to remain viable. But it is recognized that since 1975 many improvements in the supply management system have been made. The national dairy program has also successfully adapted to new challenges and changes in demand as well as in the structure of the industry. Such flexibility and ability to adapt have been permitted by the structure put in place to administer the program. If the policy keeps abreast of production, market and technological changes, it should continue to meet its goal of providing stability of price and production for both producers and consumers.

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